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CHIEF CLERK'S OFFICE



Terry Gloriod  
President

July 17, 2003

Illinois Commerce Commission  
527 E. Capitol Avenue  
Springfield, IL 62701

Attention: Elizabeth Rolando  
Chief Clerk of the Commission

01-0832  
Report

Dear Ms. Rolando:

We are providing a July 15, 2003 report from Standard and Poor's which raises the credit rating of American Water Capital Corp to 'A'.

Very truly yours,

A handwritten signature in cursive script that reads "Terry L. Gloriod".

Terry L. Gloriod  
President

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## **Your Connection to Standard & Poor's Utilities Ratings Team**

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### **American Water Capital Ratings Raised, Off Watch; Thames Water Ratings Affirmed**

**Publication date:** 15-Jul-2003

**Analyst(s):** Dimitri Nikas, New York (1) 212-438-7807

**Credit Rating:** A/Negative/A-1

#### **Rationale**

On July 15, 2003, Standard & Poor's Ratings Services raised its long-term corporate credit rating on American Water Capital Corp. (AWCC) to 'A' from 'A-', and its short-term corporate and commercial paper ratings to 'A-1' from 'A-2' and removed them from CreditWatch. The outlook is negative. The ratings of AWCC, a wholly owned subsidiary of American Water Works Co. Inc. (AWK; unrated), reflect the strong support arrangement with its parent, AWK, and in turn, the strong parental support stemming from ownership of AWK by the German multi-utility RWE AG (A+/Negative/A-1). AWCC acts as the funding vehicle for AWK's regulated water utility companies.

In determining the ratings of AWCC, Standard & Poor's considers the stand-alone credit profile of AWK and then notches up the stand-alone rating to reflect the material level of parental support from RWE and the core nature of AWK's regulated water operations to the RWE water division. However, Standard & Poor's does not equalize the ratings of the two companies. While the operations of AWK are core to the RWE group, the stand-alone credit

profile of AWK is weaker than that of the consolidated credit profile of RWE. The outlook is negative, reflecting Standard & Poor's presumption that the credit quality of AWCC will be dictated by RWE, and movements in ratings could be in the same direction. Nevertheless, movement in ratings will be evaluated periodically, to ensure that the ratings accurately reflect Standard & Poor's assessment of the level of support from RWE to AWK.

AWCC's stand-alone credit profile reflects parent AWK's strong business position, which is characterized by regulatory diversity and operations in generally supportive regulatory environments; a steadily growing customer base that is largely residential and commercial; geographic diversity with operations in more than 20 states; high-quality operations that comply with all the latest water production standard promulgated by the EPA; and a strong competitive position by virtue of the high barriers to entry encountered by new entrants. These strengths are tempered mainly by AWK's involvement in nonregulated, contract-management water business, which carries significantly more risk relative to the regulated water operations. While currently the unregulated ventures are not material contributors to revenues and cash flows, as such ventures increase in size and scope, they could influence AWK's business risk profile. Combined with a financial profile that is relatively weak, Standard & Poor's estimates that on a stand-alone basis, AWCC could be rated at the upper end of the 'BBB' rating category.

AWK is the largest water utility holding company in the U.S. with 2.8 million customers; it operates in 23 states. It is expected to contribute about 40% of RWE's water division revenues and EBITDA. About 80% of revenues and 75% of sales come from residential and commercial customers, providing a stable customer base with predictable water-usage patterns. The geographic diversity tempers the effect of adverse weather patterns on the company's cash flow and cushions the company from unfavorable rate decisions in any particular jurisdiction. On average, the regulatory environment is viewed as supportive because many states afford recovery of construction expenses with minimal delay; provide for the implementation of single-tariff pricing, reducing the complexity of multi-tariff rate proceedings; and provide regular rate increases.

AWK's financial profile is relatively weak for the current rating. Debt leverage has improved dramatically after the merger with RWE was completed, dropping to under 50% from just under 70% at year-end 2002. Funds from operations (FFO) to interest coverage is expected to continue to be under 3x over the intermediate term, while FFO to average total debt is expected to be just over 10% in the same time period. Capital spending needs will only be partly internally funded with the balance funded through debt issuances in the capital markets or through intercompany loans with RWE.

#### *Liquidity.*

AWCC has a 364-day \$500 million credit facility maturing in July 2003, which is used as backup for the company's \$500 million commercial paper program. At March 31, 2003, about \$200 million was

outstanding under the commercial paper program. Given this level of liquidity, upcoming debt maturities of \$69 million in 2003, \$41 million in 2004, and \$59 million in 2005 should not pose a problem. Nevertheless, Standard & Poor's expects that RWE will continue to provide support in the form of equity infusions and intercompany loans, alleviating any liquidity constraints.

## Outlook

The negative outlook on AWCC reflects the outlook on its ultimate parent RWE and the likelihood that if the ratings of RWE are lowered, then the ratings of AWCC could be lowered as well. The negative outlook on RWE reflects the very limited headroom available to the company at the existing rating level. Any debt-funded acquisitions, a change in the company's strategy of disposing of its noncore activities over the medium term, or the introduction of a regulator in Germany would put pressure on the rating.

## Ratings List

American Water Capital Corp.	To	From
Corp credit rating	A/Negative/A-1	A-/Watch Pos/A-2
Commercial paper	A-1	A-2

Complete ratings information is available to subscribers of RatingsDirect, Standard & Poor's Web-based credit analysis system, at [www.ratingsdirect.com](http://www.ratingsdirect.com). All ratings affected by this rating action can be found on Standard & Poor's public Web site at [www.standardandpoors.com](http://www.standardandpoors.com); under Credit Ratings in the left navigation bar, select Credit Ratings Actions.

For a complete list of ratings, please click the hyperlink provided here

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